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CIA-RDP85T00875R00160003

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DIRECTORATE OF  
INTELLIGENCE

# Intelligence Memorandum

*Recent Trends In The South Vietnamese Economy*

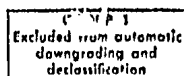
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FR IM 70-98  
July 1970

Copy No. **71**

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CENTRAL INTELLIGENCE AGENCY  
Directorate of Intelligence  
July 1970

INTELLIGENCE MEMORANDUM

Recent Trends In The South Vietnamese Economy

Introduction

South Vietnam's gross national product (GNP) in real terms has grown in recent years largely because of the rapid growth of services and construction associated with military activity. These war-related activities have made little contribution, however, to consumer welfare or the productive capacity of the civilian economy. Until 1969, domestic production of goods generally was stagnant, and the total supply of goods increased somewhat only because of growing imports. At the same time, however, demand, fed by increasing expenditures on the part of both the government of Vietnam and the Allied military forces, grew rapidly. This gap between supply and demand led to rapid inflation. Prices generally followed the trend in money supply, although a few marked short-term fluctuations in the velocity of circulation of money occurred, particularly in recent months. This memorandum analyzes major developments in the South Vietnamese economy during 1969 and early 1970 and assesses the prospects for stabilization in the near future.

Inflation

1. At the outset of 1969, South Vietnam was in the middle of an eight-month inflation-free

*Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research and coordinated with the Office of Current Intelligence, the Office of National Estimates, and the Director's Special Assistant for Vietnamese Affairs.*

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period. This remarkable hiatus in a long-term inflationary situation resulted from a combination of factors affecting both supply and demand. Supplies of domestically produced goods were increasing, and because of improved security there were few problems in transporting them to market. The price of rice -- the most important item in the cost of living index -- was relatively stable and the rice trade functioned smoothly. Moreover, there was an enormous increase in the supply of imported goods. Imports during the period September 1968 through April 1969 amounted to \$530 million, or almost 60% more than imports during the previous eight months. This increase in the supply of both domestic and imported goods outstripped the growth of demand, which was dampened by a slowdown in the growth of the money supply. From the end of August 1968 through April 1969, the money supply increased only about 5%, compared with an increase of nearly 50% during January-August 1968. Several factors contributed to this slower growth in money supply: the burst of spending on post-Tet offensive mobilization and reconstruction passed its peak, the government delayed granting a pay increase to the military and civil service, and revenues, especially from import taxes, increased considerably. In addition, the velocity of circulation (the rate at which money changes hands for purchases of goods and services) apparently increased very little from the low level that prevailed following the 1968 Tet offensive. Consumers continued to be cautious in their spending.

2. The major stabilizing factors -- the flood of imports and the delay in government spending -- were of limited duration. The high volume of imports had drawn down foreign exchange reserves from an all-time high of \$390 million at the end of September 1968 to \$275 million at the end of July 1969. To halt the rapid decline in reserves, the government decided in May 1969 to ration foreign exchange for several months by delaying action on import license applications. At the same time, a pay increase for all government employees was announced effective on 1 July. (The money actually was disbursed in October, retroactive to 1 July.) Since government salaries and allowances account for more than two-thirds of total government spending, this pay hike greatly

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increased government outlays. Moreover, the Vietnamization program, which formally began in June, resulted in a speedup in the expansion of Vietnamese military forces. The acceleration in government spending combined with the impending slowdown in import arrivals because of the foreign exchange restrictions fueled inflationary pressures. Rice prices rose sharply -- 45% to 65%, depending on the variety -- between the end of April and the end of October largely because of an unusual amount of speculative activity triggered by a decline in government rice stocks (see Figure 1). As a result of all these factors, retail prices began to increase steadily, and during May-October 1969 the USAID monthly average index for Saigon rose 23% after remaining stable during the preceding eight months (see Figure 2).

3. At the end of October, a special factor contributed to the already rising prices. The government decreed a sizable increase in austerity taxes (a customs duty) on more than two-thirds of total imports. This action effectively raised the cost of imported goods by an average of about 50% and set off a wave of price increases for domestic goods as well. By the end of 1969, prices had risen 34% above the level prevailing at the beginning of the year. This price increase -- slightly more than that experienced in 1968 -- took place despite the fact that the money supply rose only 13%. The increase in rice prices and austerity taxes accounted for this phenomenon.

4. Despite its adverse effects, the October increase in austerity taxes -- in effect, a partial devaluation -- was the most important anti-inflation measure taken by the government since the devaluation of the piaster in mid-1966. Earlier in 1969 the government raised perequation tax rates (a special customs duty) on imports and issued a revised tariff schedule, but the increased revenue from these measures was too small to make a real dent in the budget deficit. By September, when expenditure plans for 1970 were known, it was clear that more drastic action would have to be taken. The government calculated that the austerity tax increase would produce about 60% more revenue from imports in 1970, resulting in a sizable increase in total government revenues, more than half of which come from imports (see Table 1).

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Table 1

South Vietnam: Government Budget a/

	Billion Piasters				
	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u> <sup>b/</sup>	<u>1970</u> <sup>c/</sup>
Expenditures	<u>61.8</u>	<u>95.5</u>	<u>114.6</u>	<u>134.2</u>	<u>181.0</u>
Military	35.2	52.8	72.0	92.0	110.0
Civilian	26.6	42.7	42.6	42.2	71.0
Revenues	<u>39.9</u>	<u>53.2</u>	<u>54.2</u>	<u>87.5</u>	<u>128.0</u>
Domestic taxes	16.0	24.8	27.5	36.5	48.0
Import taxes	23.9	28.4	26.7	51.0	80.0
US budget support	<u>23.3</u>	<u>29.8</u>	<u>24.2</u>	<u>24.3</u>	<u>53.0</u>
Deficit financing (advances from National Bank of Vietnam)	-	<u>12.5</u>	<u>36.2</u>	<u>22.4</u>	

a. Data include extrabudgetary revenues and expenditures.

b. Preliminary.

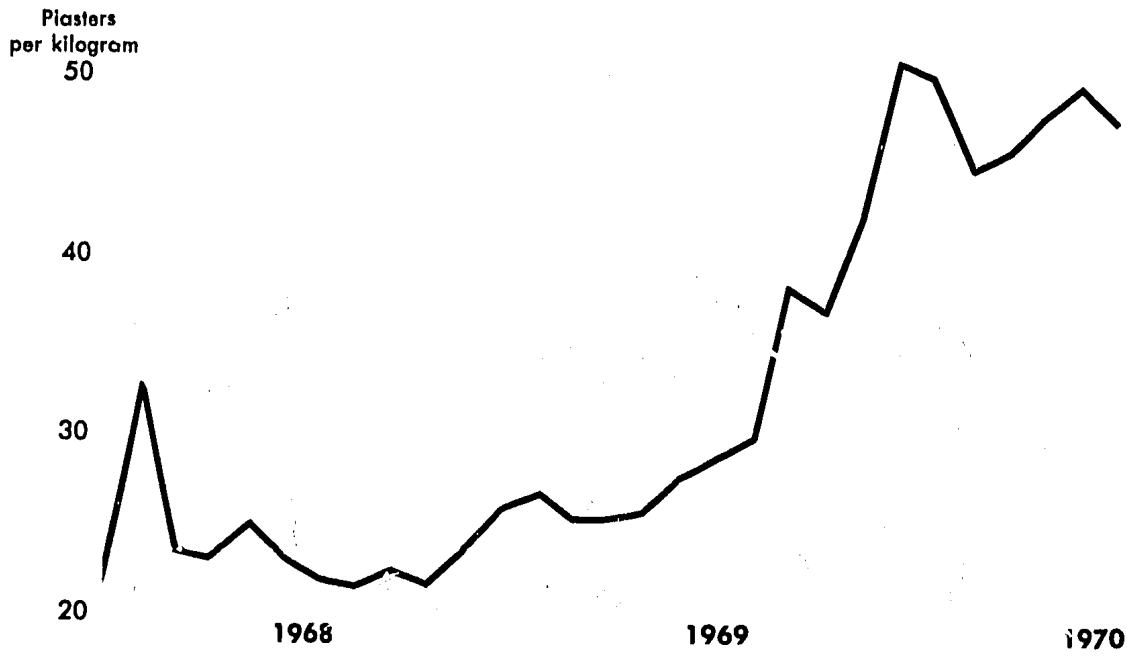
c. Original planned budget.

5. Before this beneficial effect was realized, however, a serious unforeseen economic problem arose. Because the tax measure changed only the tax portion of the cost of imports and not the foreign exchange cost -- thus widening the difference between prices of legally imported and smuggled goods -- it increased pressure on the black market for both goods and currency. From December 1968 until the austerity tax increase in late October, the black market price for dollars rose only 21%. During the remaining two months of 1969, however, the price jumped 33% and continued to increase, although at a somewhat slower pace, during the first few months of 1970. By April 1970, as shown in Figure 3, the black market exchange rate for dollars was more than three and one-half times the official rate of 118 piasters per US \$1. The austerity tax measure apparently set off a sharp rise in the demand for dollars to pay for smuggled goods, especially luxury goods imported during the

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Figure 1

**SOUTH VIETNAM**  
**Monthly Average Saigon Retail Rice\* Prices**



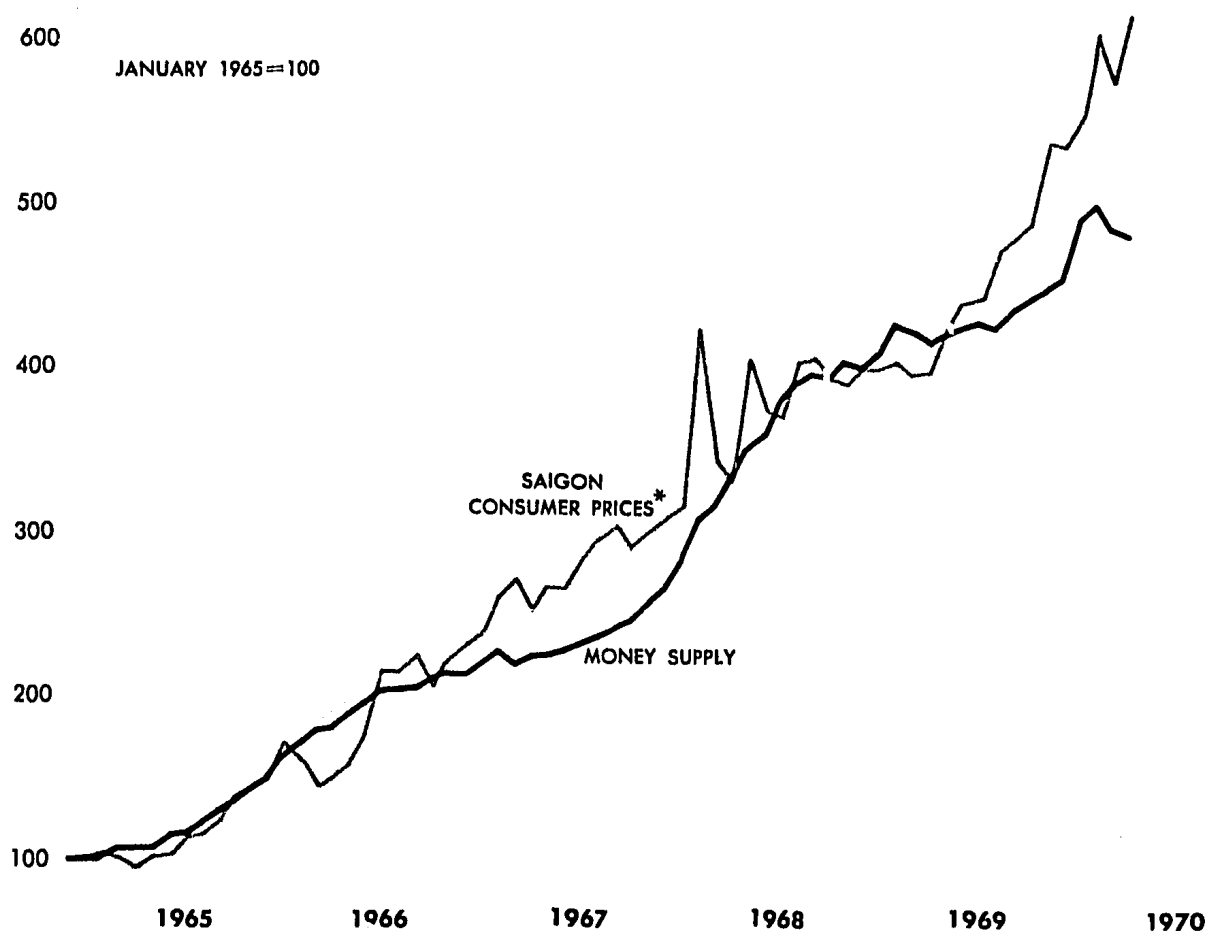
\*Rice grade no. 1/25% broken

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Figure 2

**SOUTH VIETNAM**  
**Indexes of Money Supply and Saigon Consumer Prices**

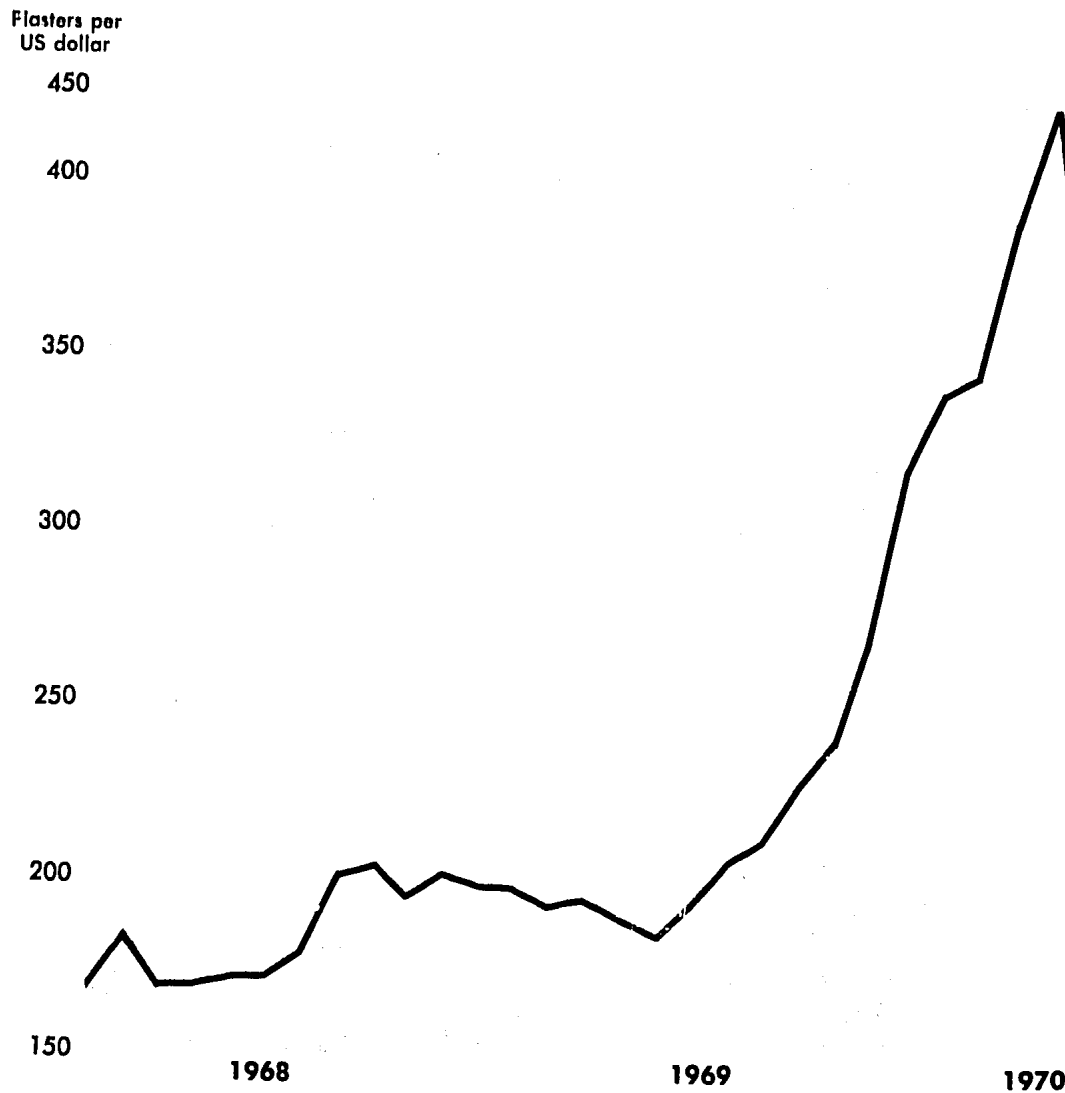


\* USAID monthly average retail price index for working class in Saigon

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Figure 3

# **SOUTH VIETNAM** **Monthly Average Saigon Black Market Dollar Prices\***



\*Official exchange rate is 118 piasters per dollar

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pre-Tet season. Several other factors, however, also undermined confidence in the piaster. Most important were continuing rumors of a devaluation and the general uncertainty about the course of the war and the political future of the country. Although less important, measures taken by US authorities to reduce the supply of dollars to the black market also may have contributed to the increase in the price of dollars.

6. Since the increase in austerity taxes, inflation seems to have become an important cause of dissatisfaction with the Thieu government. The manner in which the increase was effected -- by decree rather than through legislative action -- provoked strong criticism from the National Assembly, which had been by-passed earlier in 1969 on other tax matters. The reaction from the legislature, one of whose members took the question of the constitutionality of the decree to the Supreme Court, prompted the government to submit to the National Assembly a bill identical to the decree. This bill finally was passed with some changes on 10 June, but not before the Supreme Court had declared the decree unconstitutional and the government was forced to decree additional provisional taxes to fill the gap. The public was, of course, unhappy with higher prices for imported goods and especially with the government's inability to keep the prices of goods unaffected by the tax increase from going up as well. The monthly average retail price index rose 12% during October-December 1969 and another 18% during the first five months of 1970. The rapid rate of inflation during early 1970 stems largely from speculation that the piaster will be devalued. Consumers now prefer goods to piasters. One factor on the supply side which should have had an ameliorative effect on inflation was the large rice crop harvested in late 1969 and early 1970. Because of speculation, however, much of the new rice crop is being held off the market.

7. Between 1967 and late 1969 the real supply of goods for final consumption\* increased very little

*\* The real supply of goods for final consumption was calculated by adding imports of final products, industrial output, and agricultural production -- all expressed in 1964 prices. Imports of final products were adjusted to allow [footnote continued on p. 6]*

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while the money supply expanded rapidly (see Figure 4). Under these conditions, prices rose rapidly. The rate at which prices increased was somewhat erratic, however, because of seasonal factors and changes in expectations and import arrivals. Since late 1969 the real supply of goods has increased at about the same rate as the money supply, but prices have continued to rise. It would appear, therefore, that the recent inflation in South Vietnam is a result of changes in expectations rather than a growing supply/demand gap.

8. Although inflation is not a new problem, some groups, particularly military personnel, recently have become increasingly discontented about the cost of living. The real incomes of most government employees are deteriorating, [REDACTED]

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Moreover, the phased withdrawal of the US forces undoubtedly has caused a loss of morale. All of these factors, combined with the October austerity tax measure and subsequent price increases, have tended increasingly to focus public opinion on economic problems.

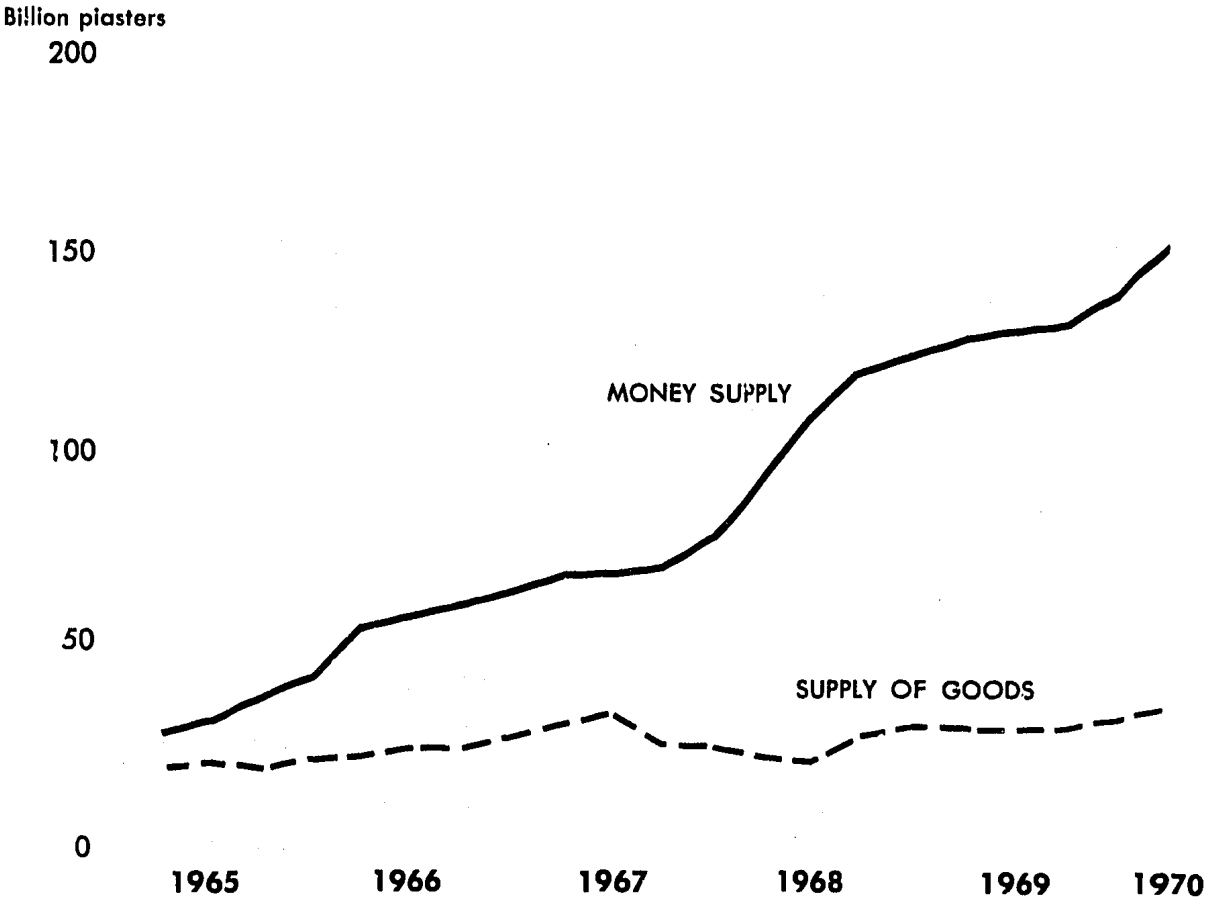
#### Wages

9. During the past five years, a major redistribution of income has occurred in South Vietnam. In 1965, government employees, especially the military, were the top salary earners in almost all cases when compared with persons of similar backgrounds and levels of responsibility employed either by the United States or in the private (non-agricultural) sector. With few exceptions, private sector employees were the lowest paid -- earning from 40% to 60% less than their counterparts in the military -- and those employed by US military and civilian agencies and their contractors generally were in the middle. By 1968, the last year for which comparable wage data are available for all sectors, incomes of those in the regular armed forces still were generally higher than incomes of

*for tariffs and mark-ups, and agricultural output was seasonally adjusted. Because of lack of data, services were not included. If services were added to total supply, the gap between supply and demand, shown in Figure 4, would be reduced.*

Figure 4

**SOUTH VIETNAM**  
**Money Supply and the Supply of Goods (1964 prices)**



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persons in other sectors. In lower paying jobs, both military and civilian government employees clearly were better off than their private sector counterparts; but at upper-middle management levels, private sector employees pulled ahead. Wages of Vietnamese employed by US agencies and contractors again usually fell in between those of government and private sector employees.

10. Between January 1968 and May 1970, workers in the US sector received wage increases averaging about 50%, and it is probable that workers in the private sector received matching, if not larger, increases. During that period, government employees received a pay increase of 1,000 piasters per month effective July 1969 as well as some increases in commissary and medical benefits. Although it is extremely difficult to measure government employees' incomes because of changes in job classification, special allowances, and in-kind benefits, it is doubtful that these changes combined with the July 1969 pay increase resulted in overall pay increases approximating those received by US and private sector employees. Moreover, because the July 1969 increase was the same for all the military and civil service, it did little or nothing to raise the incomes of upper-level officials. Thus, incomes of government employees at all but the very lowest salary levels probably have now fallen below those of their counterparts working for the United States or private employers.

11. While there has been a shift in the income of various groups during the past five years, there also has been a substantial decline in real income for many workers. From January 1965 through January 1968, the period for which data are available, the range of increases in total salary and allowances for a married man with three children was roughly as follows\*:

	<u>Percent</u>
Civil service	30 to 150
Regular army	30 to 70
US sector	35 to 80
Private (non-agricultural) sector	50 to 315

\* The tabulation was calculated from data on wage increases for ten job classifications in each of the four sectors.

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Because the piaster value of most government pay raises was the same for all employees, the largest percentage increases were received by those in lower paying jobs. In the US and private sectors the size of the increases was associated with the scarcity of skills. Since the cost of living rose 218% from January 1965 through January 1968, as measured by the monthly average retail price index for Saigon, the real incomes of most workers must have declined substantially during this period. Moreover, [redacted]

[redacted] the decline has continued up to the present time with real incomes of government employees deteriorating faster than those of workers in other sectors.

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12. Although real income of individual workers declined, the total real income of most urban households probably held its own until recently thanks to widespread moonlighting and additional family members entering the labor force. Opportunities for increased family employment, however, have diminished, at least since mid-1969, when US forces began to withdraw.

#### Manpower

13. Despite a 15% increase in South Vietnam's military and paramilitary forces during 1969 -- from 998,000 to 1,148,000 -- there is little evidence to indicate that the civilian economy has been adversely affected by mobilization. Many of those entering military service apparently either had been underemployed or were in rural areas formerly under Viet Cong control. There still are shortages of certain skills, as evidenced by the continuing employment of about 20,000 third country nationals (mainly Koreans and Filipinos), but it appears that the government's deferment policy and the entry of women into the labor force have kept disruption to a minimum. About 125,000 men employed by the civil service, national police, and private industry reportedly were given deferments in 1969. Many of these received nine weeks' military training and then returned to their civilian jobs. There are no data available on the number of women replacing men who have been drafted, but scattered reports from private employers indicate that the number probably is substantial.

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14. With the beginning of the withdrawals of US forces and the completion of military construction projects, the number of Vietnamese employed in the US sector of the economy began to decline during the last half of 1969. From an all-time high of 160,000 in June -- equivalent to 10%-15% of the country's civilian non-agricultural labor force -- the number of Vietnamese employed by the US sector had fallen to roughly 145,000 by the end of the year. During 1970, reductions in force are expected to reduce employment at least another 5%. To date, most of those who have been laid off apparently have had little difficulty finding other work. The fact that many Vietnamese working in the US sector are second and third wage earners from the same family also has lessened the hardship. There reportedly have been unemployment problems, however, in areas outside Saigon, and these problems will intensify as layoffs continue.

Rural Economy

15. During 1969 there were a number of developments that improved the lot of Vietnamese farmers. Farmers' real income rose substantially as prices they received for their rice increased far more than prices they paid for nonfarm products. Increased security of roads, waterways, and the railroad allowed farmers greater access to markets than they have had for several years. Prospects for 1970 also seem relatively good. As a result of an increase in cultivated area, good weather, and the greater use of new varieties of seed and other yield-increasing inputs, rice production in the crop year that ended 31 May 1970 reached the highest level in five years. Moreover, in an effort to gain the support of farmers and satisfy their strong desire for land ownership, the government initiated a radical new land reform program.

16. After suffering a significant decline in real income during 1968 resulting from the effects of the enemy offensives and government's rice price policy, most Vietnamese farmers had a dramatic increase in income in 1969. Although data on prices of most farm products are not yet available, the average price farmers received for paddy -- by far the most important crop -- more



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than doubled in 1969 while the prices they paid for consumer goods increased only 30% to 35%. Prior to 1968, paddy prices almost always reached their highest level in the fall just before the start of the main harvest and then declined to a low point in January as the new crop came on the market. In 1968, however, the price of paddy did not reach a high point until December and then continued to rise. In late November 1968 the government deliberately boosted the demand for domestic rice -- and thus the price of paddy -- by raising the price of imported US rice. The increase in the price of imported rice as well as a great increase in the demand for rice bran for animal feed were the major factors responsible for an increase of almost 50% in average paddy prices in the Delta between November 1968 and June 1969. During the remainder of 1969, paddy prices continued to rise -- at an even more rapid rate -- partly because of normal seasonal factors but mainly because of speculative buying by merchants and others who were aware that government stocks of imported rice were dwindling.

Agricultural Production

17. Agricultural production increased markedly during 1969 -- only the second increase during the past six years -- as the result of a very sizable increase in the output of rice, vegetables, and livestock products. Output of these important products overshadows the continued decline in the production of rubber and some other crops such as sugar cane. Output of vegetables -- an increasingly important cash crop for many Vietnamese farmers -- rose 22% in 1969, whereas production increased less than 1% in 1968. After a steady decline between 1964 and 1968, output of livestock products reached an all-time high in 1969 as poultry and egg production increased 15% and the number of hogs rose 10%. This record achievement was largely the result of a joint US/Vietnamese program to import breeding stock and feed grains and to improve livestock management practices. One indicator of the success of the program, at least in the Saigon area, was the behavior of retail prices for these products in 1969. While food prices in general increased more than 30%, prices of pork bellies, live chickens, and hen's eggs increased from only

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4% to 16% -- far less than the average increases for these items during 1967-68.

18. South Vietnam's rice output for the crop year ending 31 May 1970 was the largest since 1965 (see Table 2). The official estimate for the 1969/70

Table 2

South Vietnam: Production, Exports, Imports, and Deliveries of Milled Rice a/

Thousand Metric Tons				
Year	Pro- duction b/	Exports c/	Imports	Delta Deliveries to Saigon
1963	3,123	323	0	727
1964	3,196	49	0	505
1965	3,111	0	130	449
1966	2,893	0	434	321
1967	2,602	0	750	282
1968	2,813	0	679	302
1969	2,620	0	341	329
1970	3,069	N.A.	500-600 d/	N.A.

a. Production data are for crop years ending on 31 May of the year designated. All other data are for calendar years.

b. Converted from paddy at a milling rate of 0.60.

c. Exports consist of Delta deliveries plus withdrawals from stocks.

d. Estimated.

crop is 5.1 million metric tons of paddy, an increase of 17% above the 1968/69 crop. The most important factor in increasing output was the higher yield per hectare from both traditional and especially the new IR-8 and IR-5 rice seeds. Nationwide the average yield from all seed varieties increased 16%. In the Delta province of Dinh Tuong, where the largest area of IR-8 and IR-5 was cultivated, the yield per hectare was 42% above the 1968/69 level. During the crop year, Vietnamese farmers planted more than 200,000 hectares of IR-8 and IR-5, or about four and one-half times the

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high in 1969. Improved security was an important factor in all these achievements, especially for rail traffic and lumbering operations, but other factors also were significant. High prices were mainly responsible for attracting a large amount of rice from the Delta to Saigon in 1969 despite the fact that the 1968/69 harvest was one of the smallest in a decade. The doubling of fertilizer consumption clearly was related to the expanded use of "miracle rice" which requires heavy fertilization. Moreover, a more efficient fertilizer distribution system was in operation as a result of all importation and marketing being turned over to the private sector for the first time since the early 1960s.

20. Despite the large deliveries of surplus rice from the Delta to Saigon, the rice market generally was beset by supply and price problems for much of the year. During the first half of the year the market appeared to be operating normally. Retail prices were relatively stable despite a slight upward trend beginning in May, deliveries of rice from the Delta were at a very high level, government stocks -- mainly imports -- were declining to a more manageable level, and import requirements were lower. By the end of July, however, the situation had begun to deteriorate. Between the end of July 1969 and the end of April 1970, retail prices of domestic rice in Saigon rose 25% to 65%. Many factors were responsible for boosting prices at different times during these nine months -- higher paddy prices, the October austerity tax increase, and speculation by merchants and, most recently, by farmers.

21. Although deliveries of rice from the Delta during 1969 reached the highest level since 1965, as shown in Table 2, more than 85% of the shipments arrived during the first three quarters of the year. Fourth-quarter deliveries were at an all-time low, and shipments during the first five months of 1970 were well below expectations despite the fact that the 1969/70 harvest was the largest in five years and paddy prices were high. All observers on the scene have reported that farmers are holding rice off the market in expectation of even higher prices or a devaluation of the piaster. Farmers apparently have adequate storage facilities and, as a result of substantially higher

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incomes in 1969, are under less financial pressure to sell their crop quickly.

22. This lag in Delta deliveries occurred at a time when government rice stocks were declining. The large decline in these stocks has, in fact, been a major source of disturbance in the market. Stocks held in Saigon and the northern rice-deficit provinces, which amounted to 302,000 metric tons at the beginning of 1969, were down to 22,000 tons, of which only 2,000 tons were in Saigon, at the end of January 1970. (US and Vietnamese officials consider 150,000 tons, or a normal three-month supply, the most satisfactory level of stocks.) The decline in stocks resulted from the low level of imports during 1969 and increased demand for rice from government stocks. Imports totaled 341,000 tons in 1969, or one-half the 1968 level. A decline from the high level of government stocks in early 1969 was desirable, but when they reached a point below the 150,000-ton level in mid-year and import schedules slipped, the decline itself became a major cause of speculation. By the end of the year the government decided it had to arrange for sizable emergency imports in order to avert a rice panic. These additional shipments plus regularly scheduled imports and some reduction in hoarding have permitted the rebuilding of stocks, which by the end of May were up to 52,000 tons. As a result of the large drawdown in stocks during 1969 and the lag in Delta deliveries in 1970, imports this year, instead of declining as hoped, will be larger than in 1969, probably close to 600,000 tons.

#### Land Reform

23. With the enactment into law of President Thieu's land-to-the-tiller program in March 1970, the government has embarked on an ambitious undertaking to transfer ownership of more than one-third of the country's cultivated land to the thousands of tenant farmers and squatters now cultivating it. The new owners, numbering at least 500,000 and possibly as many as a million, will receive free title to the land, and the former owners -- both individuals and villages -- will be compensated

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by the central government.\* While this new program was being considered last year by the National Assembly, the government proceeded to lay the groundwork for it and try to seize the initiative on land reform from the Viet Cong by guaranteeing all tenant farmers that their right to occupy the land, whether given by the Viet Cong or a landlord, was secure and that rents could not be increased. In addition, installment payments were terminated for those farmers who purchased land under previous government land reform programs. The principal economic benefit of the new land policies is the stabilization and elimination of rent payments. Because the transfer of ownership will not significantly alter the existing pattern of cultivation, it is unlikely that productivity will be affected, at least given present agricultural technology in South Vietnam.

24. On paper the new land policies appear to assure increased support for the government by thousands of rural inhabitants. The key to success, however, is implementation. To date there has been no indication of the extent to which the earlier freeze on occupancy and rents is effective, and implementation of the new law has not yet begun. With the passage of the law in March, however, many tenant farmers apparently have stopped paying rent, and the government reportedly plans to accept this de facto elimination of rents as official policy. Some Vietnamese officials have said that the massive transfer of land envisioned under the new law could be completed within three years, but even with an all-out effort a much longer time will be necessary. The government is only beginning to establish procedures for land transfer, and most village governments, which will be responsible for approving applications for ownership, do not have the necessary administrative capability or trained personnel. Financing the program -- originally estimated to cost about 45 billion piasters, or roughly one-fourth of total government expenditures planned for 1970 -- will place additional strain on the budget during the next few years when defense spending probably will continue to increase.

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Moreover, the program could cost three times that amount if, as anticipated, the price of rice in March 1970, when the law was enacted, is used as the basis for valuing the land. At present the US government has earmarked \$40 million (4.7 billion piasters at the official rate of exchange) to help the Vietnamese finance the program.

Industrial Production

25. After achieving an average annual rate of growth of about 14% during 1963-67, South Vietnam's industrial output fell 9% in 1968 as the result of the damage and disruption caused by the enemy's Tet and May-June offensives. Output of all but two of the products listed in Table 3, which account for almost 80% of the weights used in constructing the official index of industrial production, fell. Production of textiles declined by about one-third. In 1969, however, the industrial sector, which consists mainly of small-scale plants producing consumer goods, not only recovered from the severe economic and psychological effects of the offensive but in many cases made significant gains as well.

Table 3

South Vietnam: Output of Principal  
Industrial Products

Product	Thousand Metric Tons <sup>a/</sup>		
	1967	1968	1969
Cotton yarn	7.4	5.0	7.6
Cotton fabric (million meters)	43.1	28.5	50.4
Beer (million liters)	130.0	119.4	134.2
Soft drinks (million liters)	89.5	92.3	120.4
Refined sugar	90.3	96.1	110.0 <sup>b/</sup>
Cigarettes	11.3	10.3	9.6 <sup>b/</sup>
Glass bottles	12.5	10.1	16.5
Cement	180.8	144.7	247.2
Paper and paperboard	20.8	19.6	33.2

a. Unless otherwise indicated.

b. Estimated.

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26. In addition to the general improvement in security and accompanying revival of consumer demand, there were two other important factors behind the recovery of industry -- a joint US/Vietnamese war reconstruction loan fund and increased local procurement of goods by the Vietnamese Army (ARVN). By the end of 1969, about \$18 million in long-term loans had been granted to industry for reconstruction and in some cases expansion of damaged plants; and ARVN orders for domestic, rather than imported, products such as clothing, wood products, canned food, and paper products more than doubled during late 1968 and 1969. In an apparently successful effort to spur the recovery of the hard-hit textile industry, ARVN reportedly purchased more than \$20 million worth of goods from local producers.

#### Foreign Trade and Foreign Exchange Reserves

27. Imports reached a new high of \$809 million in 1969 and were equivalent to 18% of South Vietnam's estimated GNP of \$4.5 billion. Exports, on the other hand, declined 36%, amounting to only \$27 million, or 3% of imports. For several years, US/Vietnamese policy has been to keep imports at a very high level in order to contain inflation. Because of the war, little has been done to stimulate import-substitution or export-producing industries. The composition of foreign trade has changed relatively little since 1965, with machinery and transportation equipment, rice, and textile fabrics and yarns accounting for roughly one-half of imports. Rubber usually accounts for about 80% of exports, but, because reexports of POL and of accumulated empty oil drums by the various foreign oil companies were included in South Vietnam's exports statistics during 1967-69, the share of rubber declined. Moreover, in 1969 there reportedly were sizable exports of scrap metal. If these items that are not normally part of South Vietnam's exports were excluded, the export data given in Table 4 would show a steady decline. The United States and Japan are the sources of about 50% and 20%, respectively, of South Vietnam's imports, and France is the major market for exports.



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Table 4

## South Vietnam: Foreign Trade

Million US \$		
<u>Year</u>	<u>Imports</u>	<u>Exports</u>
1965	371	41
1966	657	25
1967	754	38
1968	672	42
1969	809	27

28. In 1969 -- for the first time since the inception of the US aid program in 1954 -- the United States directly financed less than half of total imports. Direct US payment for imports is made mainly through AID's Commercial Import Program (CIP) and the Food for Peace Program (PL-480). The increased share of Vietnamese financing, however, was possible only because the large amount of dollars the Vietnamese government earned from the US government during the past few years had allowed the Vietnamese to build up their reserves of foreign exchange. US government purchases of piasters for official and personal uses in South Vietnam, which amounted to \$347 million in 1969 (see Table 5), accounted for almost two-thirds of Vietnam's earnings of foreign exchange during 1966-69. Because of the increased financing of imports in 1969, South Vietnam drew down its reserves of foreign exchange for the first time since 1964. Reserves fell \$56 million to \$270 million, equivalent to one-third of total imports in 1969. Moreover, a further drawdown of \$70 million occurred during the first four months of 1970. Despite the imposition of higher taxes on imported goods in October 1969, orders for imports were very high during the following three months -- probably because importers were speculating that the austerity tax increase would soon be followed by a devaluation. The sharp decline in reserves prompted the National Bank of Vietnam in late January to begin limiting issuance of foreign exchange for imports to \$20 million per month, a move that will increase inflationary

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pressure in the months to come as import arrivals decline resulting in smaller revenue collections.

Table 5

## South Vietnam: US Aid and Piaster Purchases

	Million US \$				
	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>
Commercial import program	180	233	201	118	177
Food for Peace - Title I <u>a/</u>	49	128	166	198	88
Food for Peace - Title II <u>b/</u>	10	24	33	37	28
Project aid <u>c/</u>	41	66	40	158	149
Total aid	<u>280</u>	<u>451</u>	<u>440</u>	<u>511</u>	<u>442</u>
US government purchases of piasters	N.A.	<u>337</u>	<u>290</u>	<u>311</u>	<u>347</u>
Total	280	788	730	822	789

*a. Surplus US agricultural commodities -- mainly rice, tobacco, cotton, flour, and condensed milk.*

*b. Emergency relief -- mainly food for refugees.*

*c. Technicians and commodities in support of rural development projects, public works, health, education, and the like.*

Prospects

29. The economic situation in South Vietnam has deteriorated considerably during recent months. During the eight months ending May 1970, retail prices in Saigon rose 32%; more than half of this increase occurred during the first five months of 1970, and at this rate prices would rise more than 50% during the full year -- the largest increase since 1966. Confidence in the piaster is at a very low level with the black market value less than one-third of the official rate. Rice deliveries from the Delta are far below expectations. Foreign exchange reserves are declining and by the end of April were at the lowest level since early 1966. The cumulative effect of inflation and the

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government's failure to take decisive anti-inflationary measures have made economic problems a real factor in political stability for the first time. Above all, there are the additional financial and psychological pressures resulting from the Vietnamization of the war.

30. The sharp rise in prices and black market rates since the beginning of the year, the lagging deliveries of rice from the Delta, and the decline in foreign exchange reserves are due mainly to speculation resulting from expectations of devaluation and uncertainty created by US withdrawal. Since the mid-1966 devaluation, the price level has almost tripled. The austerity tax increase of last October, rather than calming fears of devaluation, apparently fed speculation that more stringent measures were to follow. The importance of speculation in the rise in prices is indicated by the fact that prices increased 18% during the first five months of the year while the money supply increased only 5%. Consumers held goods rather than piasters. Speculation about devaluation also has been the major factor behind the soaring black market rates, which in turn have further persuaded consumers that they should spend rather than hold their money. Farmers also are aware that they are better off holding rice than piasters. In the wake of the austerity tax increase, importers apparently decided to build up their inventories knowing that their costs would be much greater following a devaluation and that goods purchased prior to devaluation could then be sold at a huge profit. Despite the higher taxes, November orders for imports using Vietnamese government foreign exchange were almost double the October level. The drawdown in foreign exchange reserves, which results from the high level of import licensing, itself tends to lessen confidence in the economy and encourages further speculation. Moreover, the 30% increase in private credit extended to importers during January-April to pay for their goods has added to inflationary pressures.

31. Although the unusually rapid inflation of recent months appears to be due primarily to

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speculation, more basic sources of inflationary pressure are likely to come into play soon. Government expenditures are bound to rise to finance new military and civilian programs, such as veterans' benefits, land reform, and the care of refugees from Cambodia. The Vietnamization process will place additional strains on the economy as the buildup of Vietnamese armed forces necessitates increased government expenditures. Moreover, the withdrawal of US forces eventually will reduce foreign exchange earnings which are needed to pay for imports that not only absorb purchasing power but also generate the largest share of government revenues. Although the money supply increased only 5% during the first five months of 1970, the growth rate probably will increase during the remainder of the year. US officials in Saigon expect a 30% increase in the money supply this year even without allowing for the increased expenditures and shortfalls in revenues they anticipate. A sizable budget supplement for 1970 already has been drawn up, and another major increase in spending may occur if the government decides that a pay increase for government employees is necessary to lift sagging morale.

32. In the face of such a large increase in money supply this year, the supply of goods probably will increase relatively little above the 1969 level. Import arrivals will decline somewhat later this year. US-financed imports will be roughly equal to the 1969 level, but Vietnamese government-financed imports probably will be 5% to 10% below last year's level. The government's earnings of foreign exchange in 1970 are expected to be about the same as in 1969, but in order to maintain reserves of at least \$200 million the government already has begun limiting the issuance of import licenses. A decline in imports probably will cause some slowdown in industrial growth since industry consists in large part of processing imported goods. The supply of agricultural products during the remainder of the year will probably increase somewhat if, as anticipated, rice deliveries pick up in the fall when the new crop begins to reach the market. The overall supply of goods may decline slightly during the remainder of the year, and, since the money supply will increase

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more rapidly than during the early part of the year, the gap between supply and demand probably will widen and increase the upward pressure on prices. Moreover, inflation could become much worse if speculation continues on top of a bigger real resources gap.

33. The government has been aware of the impending crisis for several months but has been unable to formulate a comprehensive program. Although increased revenues will result from the higher austerity tax rates recently approved by the National Assembly, additional stabilization measures will be needed. The government apparently believes that a substantial increase in domestic revenues, such as income and excise taxes, can be achieved by more effective tax administration, but the domestic revenue base is small and the government's capability to collect taxes is very limited. A devaluation of the piaster, such as occurred in June 1966, would be a highly effective stabilization measure. A large devaluation would take more money out of the hands of consumers, increase government revenues by making imports more costly, and put a stop to speculation. Despite these advantages, President Thieu is extremely reluctant to devalue the piaster, probably because the resulting initial sharp increase in prices would be politically costly, further alienating the already disgruntled military establishment and civilian bureaucracy whose support is vital to the survival of his government. As in 1966, however, devaluation could be accompanied by some form of wage increase for government employees. Such a course of action seems preferable to enacting less unpopular half-way measures that only feed speculation that more drastic ones are about to follow.

34. Whatever measures the government decides to take, it has concluded that it cannot move quickly enough using the normal legislative process. In late May, therefore, President Thieu asked the National Assembly for authority to act by decree in the economic field for a period of five months. A similar request was rejected by the legislature in March 1968 following the enemy's Tet offensive, and it is quite possible that decree authority again will be turned down, or, if approved, will

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closely circumscribe the power of the government to act. Moreover, many legislators have indicated that there is no chance for approval unless President Thieu agrees to oust the top economic officials in his cabinet. Should decree powers be granted, the government has indicated a number of areas in which it plans to take action, such as those involving the exchange rate, taxes, interest rates, and government employee benefits. Specific measures, however, apparently have not yet been formulated and probably will not be unless or until decree powers have been approved. A devaluation of the piaster for certain exchange transactions has been under discussion by US and Vietnamese officials for some time, but very little benefit is likely to accrue to South Vietnam from such a step. The partial devaluation being considered would not affect the exchange rate for the most significant transactions -- imports of goods and US government purchases of piasters for official use -- but only exports and other invisibles. Devaluation will have little effect on exports because South Vietnam has little to export in any case. The only transactions of considerable size that would be affected are conversions of foreign currency into piasters by individuals, mainly Americans assigned to or working in South Vietnam. An attractive exchange rate would capture some unknown amount of dollars that currently are converted in the black market and thus lost to the government. Probably the most significant benefit to South Vietnam would be the extent to which confidence in the piaster was restored by the narrowing of the difference between the official and black market price of piasters.

35. For the South Vietnamese, the easiest way to cope with their economic problems, including those caused by a lack of confidence, would be to obtain an increase in US aid. An increase in US aid, either by financing a larger share of total imports or by making a direct grant for budgetary support, would greatly benefit South Vietnam in the short run by allowing a buildup of foreign exchange reserves and by cutting the budget deficit. As shown in Table 5, the US economic assistance program combined with US government purchases of piasters for official and personal uses in the

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country provided South Vietnam with roughly \$800 million annually during 1966-69 in balance-of-payments support. Counterpart funds from the sale of Commercial Import Program and Food for Peace - Title I imports also provided large amounts of piasters to reduce the government's budget deficit (see Table 1). Although increased US aid could prop up the economy during the short run, it also will perpetuate South Vietnam's dependence on outside help and thus is directly counter to the long-run goal of making the economy self-sufficient. In any case, however, the Vietnamese are going to have to rely heavily on US support not only to maintain a military, paramilitary, police, and civil government structure far in excess of what the economy could hope to support with its own resources, but also to finance additional programs viewed as desirable by the United States.

Conclusions

36. South Vietnam achieved some notable economic gains during 1969. Agricultural income and production, which declined in 1968, increased considerably, and industry made a remarkable recovery from the effects of the enemy's 1968 offensives. GNP in real terms rose an estimated 9.5% in 1969. The increase in retail prices was held to 34%, roughly the same as during 1967 and 1968.

37. Despite these favorable developments, the economy currently is suffering from a crisis of confidence. Expectations of devaluation after four years during which the price level almost tripled, while the exchange rate was constant, and uncertainties caused by US withdrawal have created a speculative climate that currently is resulting in rapid price increases and loss of confidence in the piaster. There also is the prospect of an increased budget deficit this year coupled with a decline in the government's reserves of foreign exchange. The government's inability to deal strongly with these problems has contributed to the lack of confidence.

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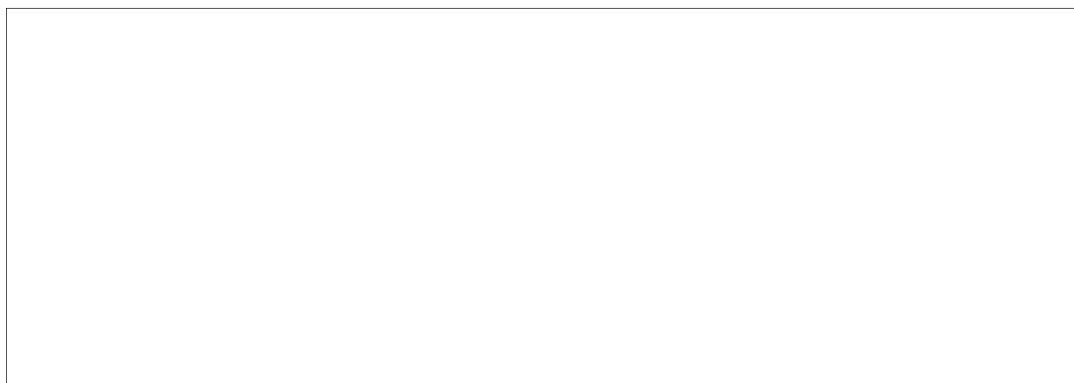
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have declined substantially for urban workers and the decline no longer is being offset by increasing family employment or moonlighting. Moreover, the deterioration in living standards is causing unrest in urban areas, a factor to which the government must give increasing weight in its political calculations. But, given the defense burden, real urban wages cannot be raised, even to earlier levels, without some or all of the following: increased US aid; increased output; or a redistribution of income. The prospects for increasing

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